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TAGS: [PREL](#) [PARR](#) [EZ](#) [KCOR](#) [MARR](#) [MCAPP](#)
SUBJECT: DEFENSE PROCUREMENT IN THE CZECH REPUBLIC: SHADY
DEALS AND BIG DOLLARS

Classified By: Charge d'affaires Mary Thompson-Jones for reasons 1.4 (b)
) & (d).

1.(C/NF) Summary: Czech Defense Ministry (MOD) procurement is plagued by lack of transparency and remains an arena for shady business deals. Successive governments seem to have viewed MOD contracts as a way to reward themselves and their political supporters with lucrative business deals, cheap asset sales, and kick-backs. The latest controversial contract for the light-armored vehicles suggests that politicians appear able to manipulate the procurement process by utilizing single source tenders, requiring the use of preferred intermediaries, and paying higher prices than other countries for similar items. Similarly, the ongoing case of the barter/sale through EADS of redundant L-159 aircraft for Casa C-295 transport aircraft may be yet another attempt to circumvent an open, competitive tender. As in the notorious 2004 Gripen fighter aircraft procurement, the Czech government has shown little political will to investigate possible high-level corruption. The large Pandur contract and the upcoming tender for new light armored vehicles will be two key tests of the MOD's ability to successfully conduct large procurements. Czech officials have taken some tentative steps toward cleaning up the procurement system. However, much more transparency is needed within the Czech MOD to prevent politicians and defense officials from manipulating the defense procurement process for personal and political gain. End Summary.

Long History of Shady Defense Deals

2.(C/NF) Since the Velvet Revolution in 1989, the Defense Ministry has had a long history of shady defense deals. Most of the scandals have centered on cheap sales of redundant military equipment and military bases to "preferred companies," over-payment on contracts, and procurements from questionable companies.

-- In 1993, the Czech Ministry of Defense purchased in a single source contract parachutes from a company closely connected to the government that had never produced parachutes. One Czech soldier died using these parachutes. Czech police investigated the purchase, but filed no charges.

-- In 1995, the Czech Army signed a contract for a new information system. Although the American computer firm Unisys won the initial competition, the then-Minister of Defense Vilem Holan (KDU-CSL) nullified the tender. EDS Digital won the new tender, but Unisys challenged the results. Some politicians alleged that EDS-Digital paid a 50 million CZK (approximately USD 2.5 million) bribe to secure the contract. These allegations were never investigated or proven.

-- Eight former Czech military officers were charged with fraudulently awarding 482 billion CZK (approximately USD 241 million) in contracts for renovating eight military airports between 1997 and 1999. However, the Prague Municipal Court dismissed the case due to the expiration of the statute of limitations.

-- In 2003, the Czech Company Trade Fides received a contract to protect the army's ammunition dumps in exchange for 2.7 billion CZK (USD 135 million). In January 2008, Czech Police arrested Miroslav Bena, the MOD's Director of Infrastructure, for accepting a one million CZK bribe (approximately USD 50,000) for awarding this contract to Trade Fides. The case still has not gone to trial.

Defense Budget: A Lucrative Arena for Manipulation

3.(SBU) With defense spending being the second largest budget item after social spending, the MOD is a potentially-lucrative arena for political manipulation. In 2008, the total defense budget was 54.2 billion CZK (around USD 2.7 billion), or 4.9 percent of the total government budget. In 2009, the defense budget will be 55.8 billion crowns (approximately USD 2.79 billion) out of total expenditures of 1,152 billion crowns (around USD 576 billion), or 4.8 percent of government spending. On average, the MOD spends around 27.7 percent of its budget on construction and procurement.

Dingo 2s: High Prices and Shady Intermediaries

PRAGUE 00000147 002 OF 004

4.(C/NF) The Czech MOD's 2008 purchases of IVECO light multirole vehicles (LMV) and Dingo 2 armored vehicles epitomizes the MOD's flawed procurement system. The MOD initially purchased four Dingo 2s without a public tender to replace or supplement U.S.-provided Humvees in Afghanistan, and then purchased approximately another 15 Dingo 2s and 15 IVECO LMVs, again through a sole-source purchase. Major General Palenik, the current Director of Military Intelligence (VZ) and the former commander of the Czech Special Forces Military Police and former commander of Czech Special Forces in Afghanistan, supported the purchase of the Dingo 2s. However, some general staff officers have complained that some MOD civilian officials forced them to take the Dingo 2s. Press reports also indicate a high degree of dissatisfaction with the performance of the Dingo 2s in Afghanistan.

5.(C) Officially, the MOD purchased the Dingo 2s under a sole source contract using VZ funds and purchase authority, due to the "urgent need" for Czech troops to have these vehicles in Afghanistan. However, given the long planning process required for both the Czech military's Logar and Helmand missions, the MOD could easily have used a competitive tender process. In September 2008, First Deputy Minister of Defense Martin Bartak faced an anonymous criminal complaint for abuse of power for his role in the Dingo purchase. When asked about the complaint soon after it was filed, Bartak said he was not aware of it.

6.(C) The Dingo 2 transaction is not unique. According to Transparency International (TI), between 2002 and 2004, over 90 percent of Czech defense procurements were done on a sole source basis. After TI released its report, the MOD removed most procurement data from its website.

7.(C) By November 2008, the Czech army had received the new batch of Dingo 2s. Czech politicians and journalists have raised serious concerns about the price for these vehicles. The MOD reportedly paid approximately USD 2 million for each vehicle. Other countries paid much less for the base vehicle. The Czech Press reported that the Norwegians paid USD 385,000 for each of their 72 vehicles, and the Belgians paid USD

220,000 for each of their 440 Dingo 2s. Military experts in Prague say that the greater volume of vehicles the Norwegians and Belgians purchased does not explain the eight to ten times difference in price.

8.(C) The difference in prices was never explained. Journalists in Prague who follow military procurements speculate that Bartak probably personally benefited from this sale. One well-connected source involved in the defense industry told the Embassy that MPI, the Czech intermediary for the Dingo 2 purchase, paid 247,249,168 CZK (around USD 12.35 million) for the vehicles and then sold them for 499,867,390 CZK (approximately USD 24.9 million) to the MOD. After subtracting the 19% VAT, MPI made a profit of 172,807,467 CZK (around USD 8.6 million), or 35%, on the vehicles. MOD watchers therefore speculate that some of the "excess profit" may have gone to Bartak and other officials. However, one observer commented that, if he benefited from the deal, Bartak would be too smart to leave any trace of his involvement. Wherever the reportedly large profits ended up, the lack of transparency fuels speculation about who benefitted from this deal.

Two Key Tests: Pandurs and New Light Armored Vehicles

9.(C/NF) The MOD faces two key tests of its ability to conduct large, competitive tenders: execution of modified Pandur II contract and the purchase of light armored vehicles. The Pandur contract has been controversial, even during the tender process. However, the contract drew additional scrutiny upon award, since the contract was signed by former Defense Minister Karel Kuehnl in his final days in office in June 2006. In the original contract, the Czechs agreed to purchase 199 eight-wheeled Pandur II armored personnel carriers produced by Steyr, a General Dynamics European Land Systems subsidiary, through Defendia CZ, for 23.6 billion crowns (approximately USD 1.2 billion). Nevertheless, the contract stood up to legal challenges in court from Patria, which had lost out in the original tender.

10.(C/NF) In November 2007, the Czech MOD claimed that the Pandur vehicles did not meet "the required specifications" and declared the contract null and void. The Czech MOD,

PRAGUE 00000147 003 OF 004

however, continued to negotiate a "modification" to the contract with General Dynamics/Steyr, appearing to have an interest in the delivery of a reduced quantity of Pandurs and in avoiding litigation. During these negotiations, a General Dynamics/Steyr representative alleged in a private conversation with an Embassy officer that Bartak, who headed the negotiations for the Czechs, engineered an opportunity for Marek Dalik, a personal friend of Prime Minister Topolaneck, to solicit a bribe from Steyr. However, U.S. Embassy Prague has no means to substantiate this allegation. In March 2008, the Czech MOD and General Dynamics signed an MOU for delivery of 107 vehicles, and a year later, on March 13, 2009, Steyr and the MOD signed a contract to deliver the vehicles.

11.(C) The Czech MOD is now planning to conduct a tender for an additional 108 light-armored vehicles this summer. Western defense companies fear that the tender may be "pre-cooked" in light of the earlier Dingo 2 deals. The original "emergency purchase" was only for four Dingo 2s. When the MOD purchased the additional Dingo 2s, it rationalized the decision to outsiders with the argument that the Czech Armed Forces need to stick with the Dingo 2 because they already had a number in service and did not want to increase their training costs, inventories of spare parts, and other associated costs. This tender will be a major test of the MOD's ability to conduct open tenders.

Well-Connected Intermediaries Stifle Competition

12.(C) The Dingo 2 and IVECO deals also raise serious

concerns about the use of well-connected intermediaries to stifle competition. Under Czech law, all arms sales require a license or the use of a Czech broker. Since the licensing process is arduous and time-consuming, most arms sales are done with the use of a Czech broker, primarily Omnipol and MPI. As the Deputy Minister of Defense for Economic Affairs from 1993-1998, the current Finance Minister, Miroslav Kalousek, inserted the requirement to utilize intermediaries into the defense procurement law. Omnipol's former chairman, Richard Hava, is rumored to have close connections with Finance Minister Kalousek and Jaroslav Kopriva, the current Deputy Defense Minister for Armaments. MPI also appears to be well connected. Its Director Michael Smrz reportedly has close connections with Bartak and Jan Vidim, the Chairman of the Defense Committee in the lower house of the Czech parliament. With these strong connections within the government, one official of a Western defense company said that his company will only compete for contracts if they are too low for MPI or Omnipol to be interested. The Czech Parliament is currently debating a new defense procurement law. However, there is little chance that this requirement to obtain a license or use an intermediary will change in the near term.

High-Priced Underwear, Black Funds, and the General Staff

13.(SBU) The one place where the Czechs have actually sought to investigate and prosecute is the Czech General Staff's use of the so-called "black funds" for personal gain. In November 2008, the Czech anti-corruption police revealed that the former Chief of the Czech General Staff, General Pavel Stefka, and other members of the General Staff spent 17.5 million CZK (approximately USD 875,000) on questionable trips, entertainment, and mountain bikes. The funds were even used to purchase underwear at 700 CZK (around USD 35) each with "Forces Development Section of the General Staff" written on the front. Twenty officers were discharged from the army and charged with misuse of government funds in connection with this scandal. The scandal even forced Major General Ivo Zboril --the former Chief of the General Staff Forces Development Section, who had been recently promoted and appointed to the position of Head of the Military Office of the President -- to retire early. In this case, Defense Minister Parkanova personally dismissed the officers involved and those with knowledge of this scandal. The case is currently with the Prague Prosecutor's Office, while the defendants review their indictments.

Gripen: An Investigation Shelved

14.(SBU) The most notorious case involving defense procurement in the Czech Republic remains the government's decision to lease Gripen fighters. The Czech government first planned to purchase 24 Gripen fighters in 2002 for 60.2

PRAGUE 00000147 004 OF 004

billion CZK (approximately \$3 billion), but decided to delay the purchase due to that year's devastating floods. In 2004, the Czechs decided to lease 14 Gripens for a period of ten years for 20 billion CZK (around USD 1 billion). OMNIPOL, one of the companies involved in the controversial Dingo 2/IVECO deal, served as the intermediary. There is widespread speculation in the press and among military observers that Saab/BAE paid around USD 60 million in bribes to secure the lease. In 2005, Senator Michal Zantovsky (of the then-Civic Democratic Alliance), currently the Czech Ambassador to Israel, reported to the Czech police that his party was offered 10 million CZK (around USD 500,000) in return for his vote in favor of the deal. The Czech police investigated, but shelved the case in late 2008 due to a lack of evidence. Unlike the Czechs, British and Swedish authorities are continuing their investigations, and Czech authorities are reportedly cooperating with them.

L-159s and EADS/CASA

15.(C) The Czech MOD has been trying to dispose of a number of redundant L-159 aircraft via a barter/sales deal with the Spanish aircraft maker CASA. The Czech press has reported that the MOD plans to swap five L-159s for one CASA C295M transport aircraft and the outright purchase of an additional three C-295Ms for 3.5 billion CZK (around \$175 million). In April 2008, Bartak signed a memorandum of understanding for this barter/sale. (Note: Due to U.S. avionics in the aircraft, any transfer of the L-159s requires U.S. approval. End Note) The MOD reportedly plans to again use the well-connected intermediary Omnipol in this deal. Some observers and competitors like Alenia, the Italian aerospace company, believe that the barter deal is yet another way in which the MOD is avoiding an open, transparent competition for badly-needed military transport aircraft (Note: The 3.5bn CZK cost associated with this deal is reportedly approximately the same sum that Alenia was seeking for the purchase of four Alenia C-27J aircraft, considered by many to be a more suitable and capable aircraft).

A Possible Move Toward Greater Transparency

16.(SBU) In 2007, Minister of Defense Parkanova gave the Director of the Division of Assets, Jiri Kral, responsibility for implementing a revamped electronic tender system, or SEPO. SEPO will seek to reduce the ability of defense ministry personnel or other individuals to manipulate tenders. The system allows for companies to bid to supply goods or services to the Czech military. The Ministry plans to post on the SEPO website tenders for goods between 5,000 CZK (around USD 250) and 2 million CZK (approximately USD 100,000) and for services between 15,000 (around USD 7500) and 6 million CZK (USD 300,000). The system will also bind vendors to their prices. Kral hoped that approximately 25 percent of defense procurements will eventually use this system. The system is working, but the number of procurements on the site is quite low and most large contracts that involve weapons systems cannot use this system.

17.(C) Comment: In 2007, Defense Minister Parkanova (KDU-CSL) said that she would work to root out corruption in the Defense Ministry. As a former justice minister, she could have been well-positioned to undertake such an effort. However, her political position was never strong, and she was unable to establish good control over the MOD. Indeed, it appears that it is First Deputy Minister Martin Bartak (ODS) who really runs the ministry.

18.(C) Bartak figures prominently in many of the alleged current procurement scandals at the MOD. Although Embassy Prague is unable to confirm any of the allegations against Bartak, the circumstantial evidence is considerable. Even with a possible change in government in 2010, defense procurement will likely remain murky. A new "Bartak" will undoubtedly emerge to take advantage of the flawed procurement process and a political culture that tolerates under-the-table deals. As we pursue closer defense cooperation with the Czech Republic, we must take into account these concerns and seek ways to structure procurements and contracts to increase transparency, minimize corruption, and eliminate potentially lucrative conflicts of interest.
Thompson-Jones